No. 83-1752

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

HUBERT H. HUMPHREY, III, Attorney General of the State of Minnesota; MINNESOTA PUBLIC UTILITIES COMMISSION; and MINNESOTA DEPARTMENT OF PUBLIC SERVICE,

Petitioners,

vs.

NORTHERN STATES POWER COMPANY, and MINNESOTA PUBLIC INTEREST RESEARCH GROUP,

Respondents.

BRIEF OF NORTHERN STATES POWER COMPANY IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Respondent NSP disagrees with Appellants' statement of the question and submits that the Minnesota District Court correctly framed the issue as follows:

> "The critical issue, dispositive of this appeal, is whether the FERC Order on the Tyrone Petition constitutes a federally approved wholesale rate as between NSP and NSP-W. If the Coordinating Agreement and its amendments constitute such a rate, then there is little dispute but that the PUC must, under the law cited, accept the Tyrone cost allocation established by FERC."

As recognized by the state courts, the underlying legal proposition, that a state ratemaking body must treat a FERC-approved rate as establishing the reasonable cost of wholesale transactions in determining a utility's operating expenses for purposes of setting an appropriate retail rate, was never seriously challenged by appellants.

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STATEMENT OF THE CASE

A. Introduction

Appellants have attempted to present this case as one involving complex issues of division of power between federal and state regulators. To the contrary, before the state trial court all parties agreed on the governing legal principles (Appendix, p. 24):

> "If the rate set by FERC is a 'rate for the wholesale sale of power,' [appellants] concede that all charges

> passed through the Coordinating Agreement would be binding on the rates to *both* wholesale customers and retail customers of NSP."

No issues of national importance, no serious constitutional debate as to the state-federal balance of jurisdiction to regulate utilities, was presented to the state courts.

This case turns, instead, on its facts. Appellants' Statement of the Case seriously misstates those facts, for the evident purpose of creating the illusion that this case involves the establishment of a mechanism to evade state regulation. That illusion is not supported by the record, is false and was never presented to the state courts.

Appellants thus present a hypothetical issue, inviting this Court to consider an advisory opinion on a "what if" scenario which is not remotely suggested by or relevant to this record. We are compelled to detail the facts. When we have done so, it will become clear that the reasons for granting the writ, as urged by Appellants, do not exist and that denial of the petition is required.

B. The Two NSP Companies

Northern States Power Company ("NSP-M") is a Minnesota corporation which provides electric service to retail and wholesale customers. Its retail service territories are located in three states, Minnesota, North Dakota and South Dakota (NSP Ex. 96, p. 2). NSP-M's retail transactions are regulated by state commissions in each of the three states. Since it does business in all three states as a single corporate entity, the transfer of its own electricity across state lines from Minnesota to North or South Dakota does not involve a sale and is not subject to federal rate juris-

diction. However, the transfer of electricity between NSP-M and any separate public utility for resale involves an interstate sale and is subject to federal jurisdiction by the Federal Energy Regulatory Commission ("FERC").

Northern States Power Company of Wisconsin ("NSP-W") is a Wisconsin corporation and a wholly owned subsidiary of NSP-M. It also provides electrical services to its own retail and wholesale customers. Its retail service territories are located exclusively in Wisconsin and are regulated by the Wisconsin Public Service Commission ("WPSC") (NSP Ex. 96, p. 2). Its wholesale transactions, including transactions with NSP-M, are regulated by FERC.

Appellants state that NSP-M incorporated NSP-W as a wholly-owned subsidiary in 1970, contemporaneously with the adoption of the Coordinating Agreement (Petition, pp. 3-4). In fact, Appellants suggest that the Coordinating Agreement was adopted *because* of the contemporaneous establishment of the Wisconsin subsidiary (Petition, p. 5). Both suggestions are factually incorrect.

NSP-W, was actually incorporated in Wisconsin on November 21, 1901, under the name LaCrosse Gas and Electric Company. It was not purchased by NSP-M until December 12, 1923. Since that time, it has remained a separate Wisconsin corporation. There was never a possibility for NSP-W to be merged into the parent, NSP-M, because Wisconsin law required that any utility operating in Wisconsin be incorporated in Wisconsin.[1] That law dates back to 1907 and was last amended in 1929. NSP-M cannot directly provide retail utility service to Wisconsin customers and must operate through a Wisconsin subsidiary

[1]Wisc. Stat. §196.53

NSP-W, as a corporation, was recognized as a separate public utility under the Federal Power Act by a 1957 order of the Federal Power Commission. *Northern States Power Company (Minnesota), Northern States Power Company (Wisconsin),* 18 F.P.C. 532, 536 (1957). (Tr. XXXII, p. 58).

C. The Coordinating Agreement

While separately incorporated, the two NSP Companies plan, operate and share the cost of generation and heavy voltage transmission facilities as a single integrated system under a Coordinating Agreement (NSP Ex. 96, p. 2). The current Coordinating Agreement was made on October 12, 1970 (Appendix, p. 49, et seq.)[2] It recites that each company owns and operates electric generation and transmission facilities, that their "systems * * * are interconnected" and that they "desire to coordinate the development and operation of their respective generation and transmission facilities *and the purchase and sale of electric power and energy* * * *."

Since the Coordinating Agreement contemplated sales and exchanges of electricity, it, like its predecessor agreements, was necessarily subject to the jurisdiction of FERC. The Agreement was filed with FERC and approved as "Rate Schedule No. 374" for NSP-M and "Rate Schedule No. 53" for NSP-W (NSP Ex. 96, p. 1; Tr. XXXII, p. 49). The state utility commissions in Minnesota, South Dakota, North Dakota and Wisconsin have recognized the Coordinating Agreement and have reflected the impact of its charges in retail rates.

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[2]The 1970 Agreement superceded an Interchange Agreement of April 15, 1960, as supplemented from time to time, which had likewise been on file with FERC as a rate schedule (Appendix, p. 66).

D. The Tyrone Project

In 1969 the NSP companies identified the need for additional generation capacity for the four State integrated system (NSP Ex. 98, p. 3). A site evaluation process began in 1970 and the Tyrone site was selected in 1972 (NSP Ex. 98, p. 3).

In the original Ownership Agreement for Tyrone, NSP-M and NSP-W each held separate, indivisible ownership interests in the Unit; 31.3% for NSP-M and 36.3% for NSP-W (NSP Ex. 96, pp. 4-5; Tr. XXXII, p. 156).[3] On February 24, 1978, the WPSC ruled under Wisconsin Statutes Section 196.53 that NSP-M, as an out-of-state corporation, could not own any portion of the project. NSP-W bought NSP-M's ownership interest by the payment of $10 million, which was NSP-M's share of construction expenditures at that time (Tr. XXXII, p. 159). From that point on, NSP-W owned the entire 67.6% share and paid all further construction expenses (Tr. XXXII, p. 164).

On March 6, 1979, the WPSC denied a Certificate of Need for the unit. A court appeal was taken, but the Tyrone Co-Owner Management Committee decided that, even if the appeal was successful, the plant could not be licensed, constructed and brought into service in time for the anticipated need (NSP Ex. 98, p. 13). The project was terminated, causing a loss on the books of NSP-W (NSP Ex. 96, p. 5; NSP Ex. 98, pp. 15-16).

E. The FERC Proceedings

Appellants suggest that, upon abandonment of the Tyrone project, "NSP * * * sought an expeditious means of

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[3]Other, non-affiliated utilities, owned the balance.

passing on its losses, which amounted to approximately $75 million, to consumers" (Petition, p. 4). Actually, upon abandonment, the entire loss of the NSP Companies was on the books of NSP-W alone. The loss for the NSP Companies and co-owners in total was then estimated at $109 million, $62 million of which had already been spent on such things as land, environmental studies, engineering and architectural plans, regulatory hearing expenses and vendor progress payments (NSP Ex. 98, p. 16; Tr. XXXII, pp. 123-127). The estimated additional losses of $47 million did not relate to penalty clauses, as asserted by Appellants (Petition, p. 5), but rather to cancellation costs under 240 vendor contracts (NSP Ex. 98, p. 16). Those cancellation costs were based on the value of work already performed, not on any penalty (NSP Ex. 98, p. 16).

Since the plant had been planned and developed for the integrated system and was within the scope of the Coordinating Agreement, it was appropriate to reflect the loss in the Coordinating Agreement charges so that they would be shared fairly by all customers of the system. On August 24, 1979, NSP-M and NSP-W filed with FERC a proposed Amendment to the Coordinating Agreement to clarify that NSP-W would amortize its Tyrone abandonment losses and reflect that amortization in charges made to NSP-M (NSP Ex. 96, p. 1; Tr. XXXII, p. 50). The Amendment reflected the amortization of $80 million[4]

[4]This amount was NSP-W's share of the original estimated loss of $109 million (NSP Ex. 98, p. 16). It was later reduced to $75 million and then $67 million as estimated cancellation charges were negotiated and settled.

over a five-year period[5] commencing on March 6, 1979.[6] By Order issued October 22, 1979 FERC accepted the Amendment, pending hearing, as a rate change proceeding under the Federal Power Act and ordered NSP-W to include in its monthly billing to NSP-M the cost of the amortization.[7]

FERC conducted hearings on the Amendment. Appellant Minnesota Public Utilities Commission ("MPUC") intervened and opposed the Amendment. The Administrative Law Judge's Initial Decision of December 4, 1980 (prior to the MPUC's Order herein), recommended approval with certain conditions (Appendix, pp. 73, et seq.). On December 3, 1981 (subsequent to the MPUC's Order herein), the FERC approved the Amendment, with a lengthening of the five-year amortization period to ten years (Appendix, p. 120, et seq.), thereby significantly reducing the annual impact on Minnesota retail rates The Minnesota and South Dakota Utility Commissions appealed the FERC Order to the Court of Appeals for the Eighth Circuit, which affirmed the FERC decision on October 19, 1982. *South Dakota Util. Comm. v. Federal Energy Regulatory Commission*, 690 F.2d 674 (8 Cir. 1982).

In the FERC proceeding, MPUC litigated the issue whether NSP-W had acted prudently in making ex-

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[5]The final FERC Order revised the amortization period from 5 to 10 years.

[6]Since the amortization commenced on March 6, 1979 (to match the date the WPSC denied the certificate of need, the amortizations taken between that date and the first dates that new retail rates could be obtained by rate change filings in the various states were absorbed by shareholders and not recovered in retail rates.

[7]The impact of the Amendment on Minnesota retail rates was $10,928,000 for the test year. The final Order of FERC reduced the test year impact to $5,991,492 by extending the amortization period.

penditures for the Tyrone project and in later abandoning it. The FERC determined that:

(1) The Tyrone project was planned for the needs of both NSP companies and, if completed, would have produced charges by NSP-W under the Coordinating Agreement.

(2) The formula rate under the Coordinating Agreement had been followed for many years and was reasonable.

(3) The NSP companies had acted prudently in planning, carrying forward and then canceling the construction of Tyrone.

Appellant MPUC did not challenge the jurisdiction of FERC to act on the Amendment. FERC's jurisdiction was necessarily premised upon the fact that the Coordinating Agreement was a wholesale rate for the sale of electricity in interstate commerce, under the Federal Power Act.

FERC's Order approving the Amendment reserved the question of the reasonableness of vendor settlements for cancellation charges (Appendix p. 123). On July 12, 1983, FERC filed a Notice of Finality of Initial Decision, which adopted the Administrative Law Judge's recitation of the following events: that the FERC had reviewed the reasonableness and prudence of all vendor settlements; that NSP had submitted documentary support for the same; that all parties (including Appellant MPUC) had been given opportunity to contest the prudence of any settlement; that no party had contested any settlement and that NSP's Motion for Summary Disposition in its favor on the issue of prudence was unopposed (23 FERC ¶ 63,077, et seq.).

F. NSP-M's Minnesota Rate Filing

The FERC approval of the Amendment to the Coordinating Agreement produced an increase in the wholesale rate charged by NSP-W to NSP-M. This increase in the cost of purchased power for NSP-M could not be "automatically" passed on in retail rates since the only "automatic" adjustment clauses available to NSP-M's retail operations did not apply to the Tyrone related increases.[8] In order to change its retail rates to reflect the increase in wholesale costs, NSP-M was required to file retail rate change proceedings in each state.[9]

Accordingly, on May 1, 1980, NSP-M filed a Notice of Change in Rates with the MPUC.[10] That filing reflected the Coordinating Agreement charges to and from NSP-W as follows (Tr. II, p. 84):

(1) The revenues NSP-M received from its monthly billings to NSP-W were credited to income as Other Operating Revenues, thus reducing the revenue needed from retail customers; and

(2) The payments NSP-M made under NSP-W's monthly billings, including payments based upon the FERC approval Amendment, were

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[8]Appellants' statement that the Administrative Law Judge "expressly noted that his decision did not determine the ratemaking consequences at either the wholesale or retail level" (Petition, p. 6), is again misleading. What the Administrative Law Judge said was that his decision "may not *automatically* govern."

[9]For example, Minn. Stat. §216B.16, Subd. 1, provide that "Unless the Commission otherwise orders, no public utility shall change a rate which has been duly established under this chapter, except upon 60 days notice to the Commission." The Commission is then empowered to suspend any change in rates for purposes of conducting a hearing.

[10]NSP made similar retail filing with the state commissions in North Dakota, South Dakota and Wisconsin.

> added to expense as purchased power, thus increasing the revenue needed from retail ratepayers.

Parties opposed to the Tyrone related expenses made the identical arguments before the MPUC which the MPUC had unsuccessfully advocated before FERC.[11] After evidentiary hearings, the Minnesota Hearing Examiner recommended allowance of the full amount claimed, concluding that the "Coordinating Agreement and amendment thereto * * * is a rate schedule within the exclusive jurisdiction of the Federal Energy Regulatory Commission" and that the "supremacy clause of the United States Constitution precludes the parties to this proceeding from attacking, before the Minnesota Public Utilities Commission, the reasonableness of the rates prescribed by the Federal Energy Regulatory Commission" (Examiner's Report, p. 14, ¶¶ 5 and 6).

By Order dated April 30, 1981, the MPUC reversed the Examiner and denied recovery. The MPUC did not find management imprudence regarding Tyrone, but based its decision upon its prehearing position, stating (Appendix, p. 40):

> "*Nothing in this record has persuaded the Commission that it was wrong in its long-held belief that the WPSC acted in a parochial fashion, in disregard for and in derogation of the integrated-system concept when it denied the need certificate for Tyrone on solely western Wisconsin growth projections.* That decision was made on the wrong grounds, even without consideration of the anti-nuclear bias which some parties have attributed to the WPSC." (Emphasis added).

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[11]See Tr. VIII, pp. 70 and 122; Tr. XXXIX, p. 77 and Tr. XXXII, p. 27.

G. State Court Proceedings

The Minnesota District Court reversed the MPUC, recognizing that the issue was very narrow (Appendix, pp. 24-25):

> "The parties concede that, to the extent indicated, the federal government has occupied and preempted the field of rate regulation at the wholesale level. They question neither FERC's jurisdiction over wholesale rates nor the reasonableness of FERC's decision to allow the Tyrone losses to be reflected in the cost of services of NSP's wholesale customers. (Joint brief of respondents, p. 15). Likewise, if the rate set by FERC is a 'rate for the wholesale sale of power,' respondents concede that all charges passed through the Coordinating Agreement would be binding on rates to *both* wholesale customers and retail customers of NSP. (See letter brief of respondents, June 8, 1982, p. 2).
>
> * * *
>
> While mindful of these admonitions [regarding scope of review], this Court believes, as did the North Dakota court, that the Order of the PUC asserting that it has jurisdiction over the rates previously set by FERC violates the supremacy clause of the Federal Constitution and the preemption doctrine prohibits such review. Further the PUC finding that the Coordinating Agreement with amendments is not a 'wholesale rate' is not supported by substantial evidence or in accord with applicable law."

The Minnesota Supreme Court affirmed, stating (Appendix, pp. 17-18):

> "We hold that FERC's approval of the amended Coordinating Agreement constituted the establishment of a wholesale rate. While that determination does

not directly establish the return for retail rates, which is in the exclusive jurisdiction of the MPUC, the state utilities commission is required to treat the allocated abandonment costs as expenses for power purchased in determining retail rates."

The other retail jurisdictions regulating NSP-M (North Dakota and South Dakota) have recognized the requirement that the increase in wholesale costs resulting from the Amendment to the Coordinating Agreement must be treated as a reasonable operating expense in setting retail rates. See, e.g., *Northern States Power v. Hagen*, 314 N.W. 2d 32 (N.D. 1981).

ARGUMENT

Factually, there is no basis for Appellants' suggestion that the Coordinating Agreement was designed or used as a "mechanism" to evade appropriate state regulation. Instead, the Coordinating Agreement, or some other form of wholesale rate, was legally required to not evade appropriate federal regulation. There is no basis for arguing that the Coordinating Agreement or FERC's enforcement of it usurp state ratemaking jurisdiction. Instead, the Coordinating Agreement, as a FERC wholesale rate, merely establishes the reasonableness of the price to be paid for wholesale purchases of electricity. Like any FERC rate, it impacts upon state ratemaking only to the extent that the wholesale price represents an operating expense to the purchaser, in which case the reasonableness of the FERC rate cannot be collaterally attacked in the retail ratemaking proceeding.

The decision of the Minnesota Court recognizes and appropriately applies this Court's delineation of the "bright-

line" between federal and state ratemaking bodies: the federal body establishes the wholesale rates; the state body establishes the retail rates; and, to the extent that a wholesale rate produces an expense in a retail rate proceeding, the state body cannot collaterally examine its underlying reasonableness.

A. There are no Reasons to Grant the Writ

Supreme Court Rule 17 indicates the character of reasons that will be considered to grant a writ of certiorari. Two apply to decisions of a state court:

> "(b) When a state court of law resort has decided a federal question in a way in conflict with the decision of another state court of last resort or of a federal court of appeals.
>
> (c) When a state court or a federal court of appeals has decided an important question of federal law which has not been, but should be, settled by this Court, or has decided a federal question in a way in conflict with applicable decisions of this Court."

1. There is no Conflict of State Decisions

The two other states which regulate NSP-M have approved the recovery in retail rates, as operating expenses, of the Coordinating Agreement charges, including the charges imposed by the Amendment to reflect the Tyrone-related costs. In only one of those juriscitions did the matter reach the court of last resort. In *Northern States Power Company v. Hagen*, 314 N.W.2d 32 (N.D. 1981), the North Dakota Supreme Court, ruled identically to the Minnesota Supreme Court stating (314 N.W.2d at 37-38):

> "We cannot overlook that NSP is required by the FERC order to pay a fixed wholesale rate for electricity to NSP Wisconsin which includes the amortization of the Tyrone loss. The PSC has no direct jurisdiction over interstate wholesale rates and we believe it would undermine the supremacy clause and the preemption doctrine for the PSC to indirectly assert jurisdiction over the wholesale rates by investigating the reasonableness of underlying costs in a proceeding involving retail rates. Furthermore, we believe it would frustrate the purpose of Congress in establishing reasonable wholesale rates if the reasonableness of these rates as an operating expense were inquired into by and made subject to the North Dakota PSC in establishing reasonable retail rates. If this were permitted the efforts of FERC would be reviewable by the PSC, which was not contemplated by the Congressional Act."

Further, the decisions of the Minnesota and North Dakota Supreme Courts are consistent with all state courts which have considered similar matters. The Rhode Island court, in *Narragansett v. Burke*, 381 A.2d 1359 (R.I. 1977), *cert. den.* 435 U.S. 972 (1979), correctly determined that the reasonableness of the retail utility's claim for operating expenses, which was based upon wholesale charges, must be governed by the wholesale rates filed or fixed by FERC (381 A.2d at 1362):

> "When the operating expense being investigated by the PUC is one incurred through a contract of the utility company with an affiliate, the burden is on the utility to establish the reasonableness of that expense. * * * However, the Supreme Court has said that a reasonable rate is that rate filed with or fixed by the FPC. *Montana Dakota Utility Co. v. Northwestern*

> *Public Service Co.*, 341 U.S. 246, 251, 71 S.Ct. 692, 695, 95 L.Ed. 912, 919 (1951). * * * Thus the rate increase in the cost of electricity to Narragansett, filed and bonded by Nepco, constitutes an actual operating expense and must be so viewed by the PUC." (Citations omitted.)

Other state court decisions in accord are *Chicago v. Illinois Commerce Commission*, 150 N.E.2d 776 (Ill. 1950); *United Gas Corporation v. Mississippi Public Service Commission*, 127 S.2d 404 (Miss. 1961); *Citizen Gas Users Association v. Public Utilities Commission*, 183 N.E.2d 383 (Ohio 1956); *Public Service Co. of Colorado v. Public Utilities Commission*, 644 P.2d 933 (Colo. 1982) and *Eastern Edison Co. v. Department of Public Utilities*, —— N.E.2d ——, 388 Mass. 292 (Mass., 1983). We have found no decisions to the contrary.

2. There is no Conflict with a Federal Court of Appeals

Likewise, there is no conflict between the Minnesota and North Dakota decisions and any decision of a federal court of appeals. One relevant court of appeals decision, of course, involves the MPUC's appeal from the FERC Order approving this Amendment to the Coordinating Agreement, *South Dakota Public Utilities Commission v. FERC*, 690 F.2d 674 (8 Cir. 1982). That decision, affirming FERC's approval of the Amendment, is totally consistent with the Minnesota decision in the instant matter.

An even more recent decision of the same court of appeals deals with the identical argument of the MPUC, that the Coordinating Agreement is not a wholesale rate. In

Minnesota v. FERC, —— F.2d —— (8 Cir., *Slip Opinion* filed May 15, 1984); (appended at the end of this brief), the MPUC again intervened before FERC in a proceeding brought to further amend the Coordinating Agreement between the NSP Companies. This Amendment proposed a method for determining the rate of return component of the charges. The MPUC challenged FERC's jurisdiction to review the Amendment, contending, as they do here, that the Coordinating Agrement "serves simply as a mechanism for allocating costs among the NSP companies and does not establish a wholesale rate for the resale of electricity." *Slip Opinion*, p. 4. The Court of Appeals rejected this contention, noting the consistency between FERC's determination and that of the Minnesota Supreme Court. The Court of Appeals agreed that interstate transfers of power between the two companies was adequately established by showing that they shared continuous access to an integrated energy pool and that the Coordinating Agreements use of formula rates qualified it as a wholesale electric rate. *Slip Opinion*, pp. 6 and 7.

3. There is no Conflict with Decisions of this Court

This Court has frequently considered the scope of FERC's jurisdiction under the Federal Power Act and has consistently determined that it is exclusive. *Connecticut Light & Power Co. v. Federal Power Commission*, 324 U.S. 515, 529 (1945); *Jersey Central Power & Light Co. v. Federal Power Commission*, 319 U.S. 61, 67-68, 70-71 (1943); *Federal Power Commission v. Southern California Edison Co.*, 376 U.S. 205, 209 (1964); and *Federal Power Commission v. Florida Power & Light Co.*, 404 U.S. 453,

460 (1964). Similarly, this court has ruled that a wholesale rate filed and made effective by FERC is the "just and reasonable rate" and cannot be collaterally challenged. *Montana-Dakota Utilities v. Northwestern Public Service*, 341 U.S 246, 251 (1951):

> "We hold that the right to a reasonable rate is the right to the rate which the [federal] Commission files or fixes, and that, except for review of the Commission's Orders, the courts can assume no right to a different one on the ground that, in its opinion, it is the only or the more reasonable one."

Appellants are plainly wrong in asserting that the Minnesota court "ignored clear pronouncements of this Court and Congress" (Petition, p. 8). That assertion is based upon a misrepresentation of the Minnesota decision: Appellants' truncated quotation from the Minnesota Supreme Court's opinion, "FERC's jurisdiction is plenary" (Petition, p. 11), is a distortion of the full statement, "Thus, the FERC's jurisdiction is plenary and extends to all wholesale sales in interstate commerce." (Appendix, pp. 9-10). Clearly the Minnesota court recognized and honored the "bright-line" between federal and state jurisdiction. It recognized, as this Court has recognized, that Congress intended to place the question of interstate rates, as to which affected states would have competing interests, in the hands of a federal agency, which would fill the gap observed in *Public Utilities Commission of Rhode Island v. Attelboro Steam & Electric Co.*, 273 U.S. 83 (1924), and assure that interstate sales are regulated. It recognized that the Coordinating Agreement was a wholesale rate within the exclusive jurisdiction of FERC and that the FERC Order ap-

proving the Amendment was a rate order which could not be collaterally challenged.

Appellants' reference to the recent decision in *Arkansas Electric Cooperative Corp. v. Arkansas Public Utility Commission*, —— U.S. ——, 103 S.Ct. 1905, 76 L.Ed. 1 (1983) raises no conflict. In *Arkansas Electric*, this Court held that a state regulatory body could examine the reasonableness of wholesale rates of an electric cooperative because those rates were not regulated by the FERC under the Federal Power Act. The Court determined that the Rural Electrification Act, unlike the Federal Power Act, did not provide exclusive jurisdiction to the Rural Electrification Administration since its own terms presupposed concurrent state review. In fact, this Court expressly distinguished wholesale rates approved by FERC, as to which FERC's jurisdiction is exclusive (76 L.Ed. at p. 9):

> "If AECC were not a rural power cooperative, the wholesale rates it charges to its members would, under the scheme we described in Part I *supra*, be subject *exclusively to federal regulation*. See §201(b) of the Federal Power Act, 49 Stat. §§838, 847, as amended, 16 U.S.C. §824(b) (1976 ed. supp. V); * * *." (emphasis added).

Unable to support any argument that the Minnesota Court misapplied the bright-line analysis to the facts of this case, Appellants proffer a hypothetical scenario, where a utility structures the ownership of its generation and transmission system to produce "the end of most state utility ratemaking jurisdiction" (Petition, p. 9). We doubt that such a scenario could ever occur. In any event, such a scenario doesn't have the remotest relevance to the facts presented here.

First, the NSP companies have shown no intent to avoid state regulation, NSP-W is maintained as a separate corporation, because of the compulsion of Wisconsin law not to limit state regulation. Where NSP-M is not under such compulsion, it operates in three other states without the use of subsidiaries.

Second, the separate incorporation of NSP-W has a very minor effect on state regulation. NSP-W owns only a small part of the integrated system's generation and transmission facilities. Thus, the impact of the Amendment to the Coordinating Agreement upon the Minnesota retail rates of NSP-M was less than 1%. *South Dakota Utilities Commission v. Federal Energy Regulatory Commission*, 690 F.2d 674, at p. 676 (8 Cir. 1982). Even as to this minor impact, the MPUC had full opportunity to intervene before FERC on behalf of retail customers and oppose the Amendment. This collateral estoppel impact of federal wholesale rates leaves state rate-making jurisdiction fully intact. In fact, its intrusion is much less than the unquestioned impact of other federal laws, such as federal income tax laws or federal minimum wage and hours laws, which significantly affect the operating expenses of utilities.

Third, even though NSP-W was separately incorporated, NSP-M still sought to hold a share of the ownership of Tyrone. Obviously, if NSP-M had intended to use the Coordinating Agreement as a mechanism to evade state regulation relative to Tyrone, it would not have attempted to share in the ownership of Tyrone. It was prevented from holding such ownership by Wisconsin law and actions of the WPSC.

The essential functions of state retail ratemaking, as contemplated by the Constitution, are clearly not threatened

under the facts of this case. If Appellant's scenario were worthy of review, such review would have to await a far different record than that presented here.

B. The Coordinating Agreement is an Interstate Wholesale Rate

1. The "Allocation" Argument

Appellants seek to avoid the "bright-line" between federal and state jurisdiction by questioning whether the charges made pursuant to the Coordinating Agreement constitute federally regulated interstate wholesale rates (Petition, p. 12, et seq.):

> "The NSP Coordinating Agreement is a simple cost allocation formula. It is not, nor does it establish, a wholesale rate for the resale of power. It is unlike a wholesale rate in purpose."

This same argument was specifically rejected by FERC and the Court of Appeals in *Minnesota v. FERC, supra*. The attempted distinction between a rate and an allocation formula is without substance. The use of an "allocation formula" as a part of a "wholesale rate" is common to FERC (Tr. XXXII, pp. 50-58). In no sense are the concepts of "allocation formula" and "interstate wholesale rates" mutually exclusive. Whether a wholesale rate is involved turns not on whether an allocation of costs is accomplished, since all rates in effect function to allocate total cost responsibility among the customers, but whether the allocation of costs is between two separate public utilities and relates to an interstate sale of electricity at wholesale.

The Coordinating Agreement itself demonstrates that it is a rate for interstate sales at wholesale and not a mere

accounting allocation of joint costs which may be done internally within a single utility. Allocations of joint costs of a single utility occur when a single corporate entity provides utility service to customers in more than one state, such as NSP-M's service in Minnesota and North and South Dakota. NSP-M must allocate its joint costs among each of the states for purposes of setting retail rates. Within NSP-M no funds are actually transferred for energy produced in Minnesota, for consumption in South Dakota or North Dakota, because no wholesale sale occurs.

For transactions between NSP-M and NSP-W, the situation is entirely different. The exchanges of electricity between NSP-M and NSP-W under the Coordinating Agreement are metered, bills are issued monthly and the bills must be paid (Appendix, pp. 57-63).

Because NSP-W is separately incorporated, as required by Wisconsin law, it is a separate and independent "person" and a separate "public utility" under the Federal Power Act, Section 201(e), 16 U.S.C. §824(e). The two companies are thus legally prohibited from exchanging electricity except under the jurisdiction of FERC, through a coordinating agreement or some other form of FERC regulated rate schedule (Tr. XXXII, p. 111).

2. Wholesale Rates may Take the Form of a Formula Rate

The provisions of the Coordinating Agreement constitute what are commonly known as "formula," "tracking," or "travelling" rates — the rate schedule designates procedures by which monthly payments will be computed from cost data that changes from time to time (Tr. XXXII, p. 51). The use of formula rates is well recognized in FERC

practice, is explicitly permitted by the Federal Power Act and has been approved by the courts. See, e.g., *Central Power & Light Co.*, 11 FERC ¶61,102, 61,227-9 (May 2, 1980); 16 U.S.C. §824d(4); *Louisiana Public Service Commission v. FERC*, 688 F.2d 357 (5th Cir. 1982), *cert. denied*, —— U.S. ——, 103 S.Ct. 1770 (1983); and *Minnesota v. FERC, supra.*

Appellants make the strange assertion that "not all rate schedules are wholesale rates." (Petition, p. 12). Clearly all FERC rates schedules are, by definition, wholesale rates. The term "rate schedule" is defined by FERC regulation to mean a statement of (a) "electric service," (b) the rates and charges to be imposed and (c) the classifications, practices, contracts etc. 18 C.F.R. §35.2(b). "Electric service" is defined broadly to mean the transmission of electric energy in interstate commerce or the sale of electric energy at wholesale for payment or compensation, whether by purchase and sale, interchange, exchange, wheeling charge, facilities charge, rental or otherwise. 18 C.F.R §35.2(a). The designation by FERC of the Coordinating Agreement as a rate schedule clearly means that it is considered by FERC to be a wholesale rate. In fact, FERC would have no jurisdiction over the Coordinating Agreement if it was not a wholesale rate.

The North Dakota Supreme Court agreed that the Coordinating Agreement was an interstate wholesale rate, stating (314 N.W.2d at 33):

> "Within their single power supply system the two companies interchange electric energy at wholesale in interstate commerce. Because NSP and NSP Wisconsin are separate corporations exchanging power at wholesale in interstate commerce their intercompany

wholesale exchanges of power fall within the jurisdiction of the Federal Energy Regulatory Commission (FERC).

The prescribed procedure for NSP and NSP Wisconsin to operate their integrated system of supplying electrical energy requires submitting their arrangement and the resulting charges between the companies to FERC for its regulation and approval. This procedure uses a formula rate contract known as a coordinating agreement which sets forth how the exchanges of energy between the companies will be accomplished."

3. NSP-M and NSP-W make Wholesale Sales

NSP-W owns generating facilities, and the energy it generates flows into the four-state integrated system (Tr. XXXII, pp. 131 and 146). NSP-M owns substantial generation capacity and its generation likewise flows into the integrated system. It is impossible, of course, to actually trace the flow of any one kwh of electricity (Tr. XXXII, p. 146), but it is well recognized that sales on an integrated electric system may be made without reference to the physical flow of electrons. *FPC v. Florida Power & Light Co.*, 404 U.S. 453, 466-469 (1972) and *Minnesota v. FERC, supra.*

Since both companies own generating facilities, and the flow of electricity can go in either direction at any point in time, their interconnection necessarily produces exchanges of electricity which are wholesale sales and are subject to FERC jurisdiction.

4. NSP and FERC have Treated the Coordinating Agreement as a Wholesale Rate

Appellants contend that NSP has not always treated the Coordinating Agreement as a wholesale rate in the past. The question whether the Coordinating Agreement is an interstate wholesale rate is, of course, a question of law and depends upon an analysis of the Federal Power Act. Obviously, if the Agreement is an interstate wholesale rate under the law, actions or expressions to the contrary by NSP would have no legal effect. In any event, NSP's actions have been completely consistent with the view that the Agreement is an interstate wholesale rate.

FERC, likewise, has uniformly treated the Coordinating Agreement as a wholesale rate. In its most recent review of the Coordinating Agreement, FERC clearly and properly articulated its view of the Agreement as a wholesale rate (*Northern States Company (Minnesota)*, 23 FERC ¶ 61,026):

> "As our discussion demonstrates, the Coordinating Agreement does establish rates and charges, albeit through formula rates, for the use of generation and transmission facilities which have been dedicated to coordinated operation. * * * The fact that the agreement does not specify unit demand or unit energy charges, as noted by MPUC/AG, is irrelevant. The unit costs can be determined by dividing the reported calendar year fixed and variable costs by the amount of capacity (kw) each party is assigned by the participation ratios and the number of kwh taken by each party.

> The agreement establishes the means by which the interstate transfer of power between the companies occurs and the intercompany charges for such transactions. The terms and conditions of this transfer are within the exclusive jurisdiction of this Commission. Consequently, any amendments to that agreement are also within our jurisdiction. * * *
>
> Our determination will only affect retail rates to the extent that the State is required to treat the allocated costs as expenses for purposes of determining the retail rates. Such a situation is not unique and is typical to the entire wholesale-retail regulatory process."

C. National Regulatory Policy is Intact

Appellants suggest that the Minnesota decision "endorses FERC usurpation of retail rate setting functions upon the absolute fiction that a cost allocation agreement between a utility company and its wholly-owned subsidiary is a FERC regulated wholesale rate" (Petition, p. 17). As demonstrated above, FERC has not usurped any retail rate setting functions; it has exercised its exclusive jurisdiction as conferred by Congress. The Minnesota Court, like all other state courts to rule on the question, has properly recognized the preemptive effect of FERC's wholesale rates when collaterally attacked in a state retail proceeding.

Appellants further suggest that additional FERC usurpation is threatened in another FERC proceeding involving the rate of return to be applied to the Coordinating Agreement (Petition, p. 18). Clearly, the Coordinating Agreement, as every other wholesale rate, has a rate of return

component which must be established by FERC. FERC's establishment of the rate of return component in the Coordinating Agreement does not impinge upon the state's establishment of a rate of return relating to retail rates. It impacts upon state retail rates only to the extent that a wholesale cost to the utility, which reflects a FERC-established rate of return, is an operating expense for purposes of establishing retail rates. The state commissions retain full jurisdiction to determine the appropriate retail rate of return, which may, and frequently does, differ from that used by the FERC. The Court of Appeals for the Eighth Circuit, as indicated earlier, has reviewed the MPUC challenge to this FERC proceeding and determined (Minnesota v. FERC, slip opinion, p. 8, appended at the end of this brief):

> "Because a change in the rate of return on investment affects the wholesale rate under the Coordinating Agreement, the Commission possessed jurisdiction to review and approve the proposed amendment."

Obviously, any wholesale rate, whether in the form of a formula or a price per unit rate, determines the purchased cost of electricity for state retail ratemaking where the purchase is relevant to the utility's operating expenses. To contend that state utility commissions should be exempt from recognizing wholesale rates set by FERC, is to argue that FERC's exclusive jurisdiction over wholesale rates should be made meaningless. FERC's jurisdiction does have meaning; it establishes the just and reasonable cost of wholesale purchases. *Montana-Dakota Utilities v. Northwestern Public Service*, 341 U.S. 246, 251 (1951). While a state retail Commission cannot collaterally attack the FERC rate by attempting, in a retail proceeding, to independently de-

termine the reasonableness of its underlying costs, the state Commission can adequately protect the retail customers by participating in the wholesale ratemaking process before the FERC and, where necessary, the federal courts. In fact, the MPUC did fully participate as an intervenor before FERC and the federal courts in connection with the amendment of the Coordinating Agreement.

CONCLUSION

The Coordinating Agreement is clearly a wholesale rate within the exclusive jurisdiction of FERC. The wholesale charges paid by NSP-M pursuant to that Agreement, as approved by FERC, represent an operating expense for the purpose of establishing retail rates. In reviewing that expense, the MPUC cannot independently inquire as to its underlying reasonableness, which is exclusively determined by FERC. The Minnesota Supreme Court correctly interpreted the scope of the Federal Power Act and correctly recognized the preemptive effect of that act with respect to the establishment of interstate wholesale rates.

The Petition for a Writ of Certiorari should be denied.

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APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 83-1745

State of Minnesota, by its Attorney General, and Minnesota Public Utilities Commission,

Petitioners,

v.

Federal Energy Regulatory Commission and the United States of America,

Respondents,

and

Northern States Power Company (Minnesota); Northern States Power Company (Wisconsin); Lake Superior District Power Company; Public Service Commission of Wisconsin,

Intervenors.

No. 83-2271

State of Minnesota, by its Attorney General ,and Minnesota Public Utilities Commission,

Petitioners,

v.

Federal Energy Regulatory Commission and United States of America,

Respondents,

and

Northern States Power Company (Minnesota) and (Wisconsin) and Lake Superior District Power,

Intervenors.

Petitions for Review of Orders of Federal Energy Regulatory Commission.

Submitted: February 15, 1984

Filed: May 15, 1984

Before BRIGHT, ARNOLD, and FAGG, Circuit Judges.

BRIGHT, Circuit Judge.

The State of Minnesota and the Minnesota Public Utilities Commission (collectively referred to as the MPUC) petition for review of orders[1] of the Federal Energy Regulatory Commission (the Commission) approving a proposed amendment to the Coordinating Agreement among the Northern States Power Companies (NSP Companies). The MPUC contends that the Commission lacked jurisdiction to review the proposed amendment because the Coordinating Agreement does not establish a wholesale rate for the resale of electricity. We deny the petition and affirm the orders of the Commission.

I. *Background.*

The NSP Companies are three affiliated public utilities providing wholesale and retail electric service to cus-

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[1]The Commission's orders are reported at 24 FERC ¶ 61,011 (1983); 23 FERC ¶ 61,026 (1983); and 21 FERC ¶ 61,375 (1982).

tomers in the Upper Midwest. NSP-Minnesota, the parent company, serves Minnesota, North Dakota, and South Dakota. NSP-Wisconsin and the Lake Superior District Power Company, subsidiaries of NSP-Minnesota, serve Wisconsin and the Upper Peninsula of Michigan. To achieve economies of scale, the NSP Companies develop and operate their respective generation and transmission facilities on an interconnected and integrated basis. The Companies accomplish this objective through their participation in a Coordinating Agreement, which establishes, among other things, procedures for sharing the costs of the entire system.[2]

On November 1, 1982, the NSP Companies filed with the Commission an amendment to the Coordinating Agreement. The amendment proposed a methodology for determining the rate of return on investment (or capital) as a component of the fixed costs shared by the Companies under the Coordinating Agreement. The proposed amendment included a fifteen percent rate of return on equity. The MPUC intervened and challenged the Commission's jurisdiction to review the proposed amendment. Accord-

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[2]Observing the role of the Coordinating Agreement in the operation of the NSP System, the Commission noted,

> The coordinating agreement determines charges * * * to be assessed the parties based on formula rates. System operating expenses, both fixed and variable and including such items as taxes, operation and maintenance expenses and the cost of capital, are calculated for each calendar year and then allocated to each party to the coordinating agreement based on the party's responsibility for the incurrence of such expenses. Variable costs are allocated according to the amount of kWh taken by each party in proportion to the total kWh generated. Fixed costs are allocated in proportion to the demand each party places on the total system generation and transmission investment.

ing to its brief, the MPUC challenges the Commission's jurisdiction in order to protect its interest in regulating retail electric rates and to avoid being bound by a federal determination as to rate of return on investment which will affect retail rates. The MPUC argues that the Commission exceeded its authority under the Federal Power Act and intruded upon retail ratemaking functions by accepting a filing that sets a rate of return on capital as part of a cost allocation agreement between affiliated power companies

II. *Discussion.*

The issue in this case is whether, as the MPUC claims, the Commission exceeded its jurisdiction and usurped the retail ratemaking authority of the MPUC by accepting an amendment to the Coordinating Agreement which establishes a rate of return on capital. Under the Federal Power Act, the Commission is vested with exclusive authority to regulate wholesale rates for the resale of electric power in interstate commerce. *See* 16 U.S.C. § 824(a) (b) (1976 & Supp. VI 1983);[3] *New England Power Co. v. New Hampshire*, 455 U.S. 331, 340 (1982); *FPC v. Southern California Edison Co.*, 376 U.S. 205, 215-16 (1964). In determining that it possessed jurisdiction to review the proposed amendment, the Commission found that the Coordinating Agreement among the NSP Companies established a wholesale rate for the resale of electric power in interstate commerce. The Commission's jurisdiction to re-

[3]The Federal Power Act grants the Commission jurisdiction over "the transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce[,] * * * but * * * shall not apply to any other sale of electric energy * * *." 16 U.S.C. § 824(a)(b). Section 824(d) of the Act defines a wholesale sale of electric energy as "a sale of electric energy to any person for resale."

view the proposed amendment, therefore, turns on the nature of the transactions provided for under the Coordinating Agreement.

The MPUC's challenge to the Commission's jurisdiction rests on its contention that the Coordinating Agreement serves simply as a mechanism for allocating costs among the NSP Companies and does not establish a wholesale rate for the resale of electricity. A wholesale rate, the MPUC points out, requires that there be a "sale of electric energy * * * for resale." 16 U.S.C. § 824 (d). The MPUC argues that the Coordinating Agreement does not provide for sales of electric energy between the NSP Companies and, therefore, cannot establish a wholesale rate. To demonstrate that the NSP Companies do not sell power to each other, the MPUC observes that NSP-Minnesota, which has the greatest generating capacity of the NSP Companies, does not purchase electric energy from its affiliates on a "steady, reliable basis." It also contends that the NSP Companies' failure to specify a price for a kilowatt or kilowatt hour further demonstrates that no sales transactions take place.

In evaluating the MPUC's claim that the Commission erroneously found the existence of a wholesale rate under the Coordinating Agreement, we note that our review of the Commission's orders is limited in scope. First, we are required to accept as conclusive the "findings of the Commission as to facts, if supported by substantial evidence." 16 U.S.C. § 825 *l*(b) (1976); *see Otter Tail Power Co. v. FERC*, 583 F.2d 399, 407 (8th Cir. 1978), *cert. denied*, 440 U.S. 950 (1979). In addition, we must defer to the Commission's judgment in making determinations within its area of administrative expertise. *See E.I. du Pont de*

Nemours & Co. v. Collins, 432 U.S. 46, 54-57 (1977); *FPC v. Florida Power & Light Co.*, 404 U.S. 453, 463 (1972); *Union Electric Co. v. FERC*, 668 F.2d 389, 392-93 (8th Cir. 1981).

Given the limited nature of our review, we cannot say that the Commission erred in determining that the Coordinating Agreement establishes a wholesale rate.[4] Contrary to the MPUC's assertion that the Coordinating Agreement does not provide for sales of electric energy, the Commission specifically found that "[t]he [Coordinating] Agreement establishes the means by which the interstate transfer of power between companies occurs and the intercompany charges for such transactions." 23 FERC ¶ 61,026 (1983). Indeed, the Coordinating Agreement contains numerous provisions authorizing the NSP Companies to exchange electric power among themselves in return for payment. Transactions of this nature plainly constitute "sale[s] of electric energy * * * for resale" and, as such, are sufficient to establish wholesale electric rates. *See* 16 U.S.C. § 824(d).

The MPUC's observation that NSP-Minnesota does not purchase electric power from the other NSP Companies on a "steady, reliable basis" is of little consequence to the issue before us, for nothing in the Federal Power Act suggests that the Commission lacks jurisdiction to regulate wholesale rates merely because the sales between affiliates

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[4]The Minnesota Supreme Court recently held that the Coordinating Agreement at issue in this case established a wholesale rate within the Commission's exclusive jurisdiction. *See Northern States Power Co. v. Minnesota Public Utilities Commission*, 344 N.W.2d 374, 382 (Minn. 1984). In that case, the state supreme court denied the MPUC jurisdiction to disallow costs arising from the abandonment of the Tyrone nuclear plant near Durand, Wisconsin. *Id.* at 375.

occur on an intermittent basis. In any event, the Commission need not document particular transfers of electricity to demonstrate that NSP-Minnesota received energy generated and transmitted by the other NSP Companies. *See FPC v. Florida Power & Light Co., supra,* 404 U.S. at 467-68. Rather, it may establish the transfer of electric power among the affiliates by showing that they shared continuous access to an integrated energy pool. *See Arkansas Power & Light Co. v. FPC,* 368 F.2d 376, 382 (8th Cir. 1966); *Indiana & Michigan Electric Co. v. FPC,* 365 F.2d 180, 183-84 (7th Cir.), *cert. denied,* 385 U.S. 972 (1966); *Northern States Power Co. v. Minnesota Public Utilities Commission,* 344 N.W.2d 374, 382 (Minn. 1984) (that electric power conceivably flows in interstate commerce in form of wholesale sale is sufficient for Commission to assert jurisdiction).

Similarly, we reject the MPUC's contention that the failure of the Coordinating Agreement to specify prices for units of electric power transferred among the NSP Companies reflects that sales do not take place among them. Despite the Agreement's failure to specify prices per unit of power, the Commission determined that the Coordinating Agreement establishes "rates and charges" by means of formula rates.[5] 23 FERC ¶61,026. Courts have approved the use of formulas in establishing wholesale electric rates, *see Louisiana Public Service Commission v. FERC,* 688

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[5]The Commission noted that

> The fact that the agreement does not specify unit demand or unit energy charges * * * is irrelevant. The unit costs can be determined by dividing the reported calendar year fixed and variable costs by the amount of capacity (kW) each party is assigned by the participation ratios and the number of kWh taken by each party. 23 FERC ¶ 61,026.

F.2d 357, 360 (5th Cir. 1982), *cert. denied*, 103 S.Ct. 1770 (1983; *Northern States Power Co. v. Minnesota Public Utilities Commission*, *supra*, 344 N.W.2d at 382, and we conclude that the Commission properly exercised its authority in approving the formula rate in this case. Thus, because the factual record and the application of the Commission's expertise to that record supports the Commission's conclusion that the Coordinating Agreement regulates sales of electric power among the NSP Companies, we reject the MPUC's contention that the Agreement fails to establish a wholesale electric rate.

The MPUC advances two additional arguments in contending that the Coordinating Agreement does not establish a wholesale electric rate. First, it maintains that the parties traditionally have not treated the Coordinating Agreement as establishing a wholesale rate. Second, it contends that the terms of the Coordinating Agreement are too general, and that to treat the Agreement as establishing a wholesale rate would allow the NSP Companies effectively to establish charges. The MPUC made these arguments before the Commission, and the Commission nevertheless determined that the Coordinating Agreement established a wholesale rate. We see no reason to disturb this determination.

III. *Conclusion.*

We conclude, therefore, that substantial evidence supports the Commission's determination that the Coordinating Agreement establishes a wholesale rate for the resale of electric power in interstate commerce. Because a change in the rate of return on investment affects the wholesale rate under the Coordinating Agreement, the Commission

possessed jurisdiction to review and approve the proposed amendment.

We must observe, however, that the Commission's procedures permit interested parties to intervene in the rate-making proceedings and require a public hearing on the justness and reasonableness of the proposed rate. In this case the NSP Companies and their wholesale customers entered into a settlement agreement resolving all proceedings before the Commission, leaving intact the proposed fifteen percent equity return. The MPUC reserved only its attack on the Commission's jurisdiction, and has not otherwise challenged the reasonableness of the settlement.

Accordingly, on the issue of jurisdiction, we deny the MPUC's petition and affirm the orders of the Commission here in question. As we have noted, the reasonableness of the rate of return is not an issue before us.

A true copy.

ATTEST:

CLERK, U.S. COURT OF APPEALS, EIGHTH CIRCUIT.